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In the Supreme Court of the United States

October Term, 1926.

AETNA INSURANCE COMPANY, AGRICULTURAL INSURANCE COMPANY, ALLIANCE INSURANCE COMPANY OF PHILADELPHIA, ET AL., *Petitioners,*

vs.

BEN C. HYDE, SUPERINTENDENT OF THE INSURANCE DEPARTMENT OF THE STATE OF MISSOURI, *Respondent.*

PETITIONERS' REPLY BRIEF.

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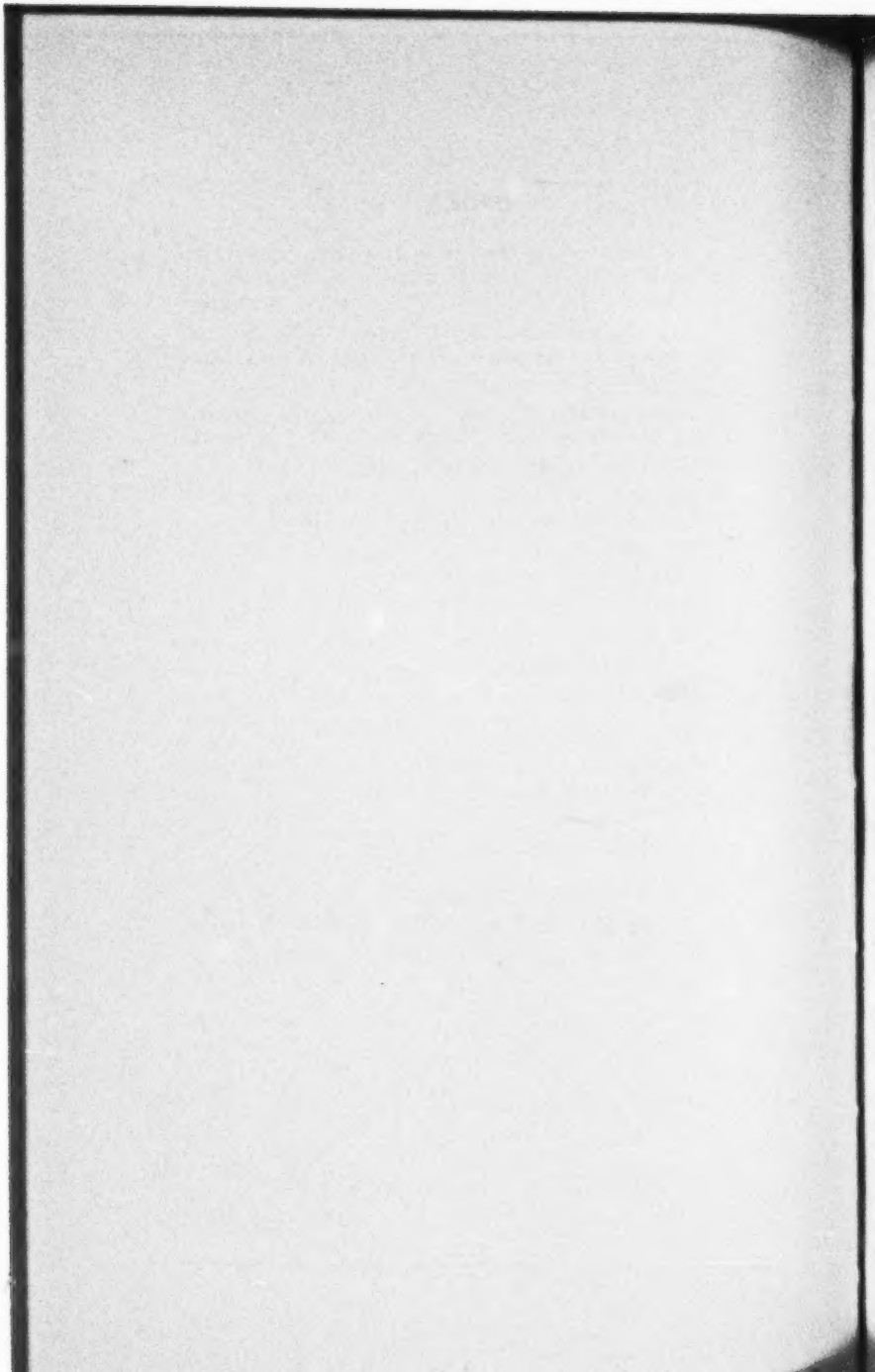

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vs.

BEN C. HYDE, SUPERINTENDENT OF THE INSURANCE DEPARTMENT OF THE STATE OF MISSOURI, *Respondent.*

No. 601.

PETITIONERS' REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

In the opening paragraph of the brief filed by the Superintendent's counsel, they charge that the statement of facts contained in petitioners' original brief is unfair and inaccurate. Yet they do not (presumably because they cannot) point out a single instance in which petitioners have made an unfair or inaccurate statement of fact.

They also charge (page 35 of brief) that petitioners' brief is "so unfair in singling out isolated portions of the testimony that we are compelled to correct some of their assertions." Yet, singularly enough, learned counsel do not point out or attempt to correct any alleged incorrect assertion by petitioners.

Petitioners' original brief does not, as counsel charge, single out isolated portions of the testimony. To the contrary, the facts relied upon by petitioners are not controverted. We assert this upon the authority of the majority opinion, which says (R. 3008-9):

> "There seems to be no dispute as to specific facts; the contest arises upon a different interpretation by the respective parties of the facts produced."

We shall now briefly answer certain contentions advanced by the Superintendent in his brief.

I.

While this court will accept the construction adopted by the Missouri Supreme Court in arriving at the meaning of the rating statute, nevertheless if the statute as construed or the rate reduction order as upheld by that court deprives petitioners of property without due process of law, this court will review the judgment.

Under the first point in his brief the Superintendent argues that the Missouri Rating Act requires that the calculation of profit or loss be made upon the received and paid basis, and requires that interest on unearned premiums be included as income; and that since the Missouri Supreme Court has so construed the Rating Act, this court is bound to follow that construction; and that

the construction being settled there is nothing for this court to review.

1. This court has held (as the Superintendent points out) that it will follow the state court's construction of state legislation; and we freely concede that proposition. Accepting the construction of the Missouri Supreme Court, that the Rating Act requires the Superintendent to use the received and paid method of calculating underwriting profit, and to include interest on unearned premiums in arriving at underwriting profit, and to exclude excess commissions and the war tax on premiums as items of expense, we agree that this court must treat the case as though the statute had expressly directed these things to be done.

2. But when a law as administered by a state court is attacked because its application violates the Constitution of the United States, a federal question is presented, to be decided by this court (*Myles Salt Co.* v. *Iberia Drainage District*, 239 U. S., l. c. 484; *Frost* v. *Railroad Commission*, 46 Sup. Ct. Rep., l. c. 605, and other cases cited at page 63 of petitioners' original brief.)

In the present case we maintain that the Rating Act as construed and applied by the Missouri Supreme Court violates the Fourteenth Amendment. The federal question raised does not challenge the construction of the Act, but is based upon a construction which, when applied, deprives petitioners of their property without due process. In such circumstances this court is not precluded from reviewing the judgment, but will determine questions raised under the Federal Constitution upon its own judgment of the actual operation and effect of the statute, regardless of how it is characterized by the state court.

In *Crew Levick Co. v. Pennsylvania*, 245 U. S., l. c. 294, this court said:

> "As in other cases of this character, we accept the decision of the state court of last resort, respecting the proper *construction* of the statute, but are in duty bound to determine the *questions raised under the Federal Constitution upon our own judgment* of the actual operation and effect of the tax, irrespective of the form it bears or how it is characterized by the state courts. *Galveston, Harrisburg & San Antonio Ry. Co. v. Texas*, 210 U. S. 217, 227; *St. Louis Southwestern Ry. Co. v. Arkansas*, 235 U. S. 350, 362; *Kansas City, etc., Ry. Co. v. Kansas*, 240 U. S. 227, 231." (Italics ours.)

In *St. Louis Southwestern Ry. Co. v. Arkansas*, 235 U. S., l. c. 362, this court said:

> "Upon the mere question of *construction* we are of course concluded by the decision of the state court of last resort. But when the question is whether a tax imposed by a State deprives a party of rights secured by the Federal Constitution, the decision is not dependent upon the form in which the taxing scheme is cast, *nor upon the characterization of that scheme as adopted by the state court. We must regard the substance, rather than the form, and the controlling test is to be found in the operation and effect of the law as applied and enforced by the State.*" (Italics ours.)

In *Standard Oil Company v. Graves*, 249 U. S., l. c. 394, this court said:

> "While this court follows the decisions of the highest court of a State, as to the *meaning* of the statutes in cases of this character, the name given to the statute is not conclusive. It must be judged

by its necessary effect, and if that is to violate the Constitution of the United States, the law must be declared void. *Minnesota* v. *Barber*, 136 U. S. 313, 319; *Crew Levick Co.* v. *Pennsylvania*, 245 U. S. 292, 294, and cases cited." (Italics ours.)

To the same effect are the following:

Galveston Ry. Co. v. *Texas*, 210 U. S., l. c. 227.
Kansas City Ry. Co. v. *Kansas*, 240 U. S., l. c. 231.
Frost v. *Railroad Commission*, 46 Sup. Ct. Rep. 605.
Dahnke-Walker Milling Co. v. *Bondurant*, 257 U. S., l. c. 290.

3. A simple answer to the Superintendent's contention is that if the Rating Act does require something which is unreasonable, fundamentally erroneous, confiscatory and unconstitutional (i. e., the use of the received and paid method, and the application of investment earnings toward a reduction of underwriting rates, and the disallowance of legitimate expenditures actually incurred), then the statute is unconstitutional and void, and this court has jurisdiction to so decide, regardless of how the statute has been characterized by the Missouri Supreme Court. If the statute as written is not confiscatory and unconstitutional, but if the reduction order as upheld by the Supreme Court is so, then the reduction order is likewise unconstitutional, and this court has jurisdiction to do decide.

The argument of the Superintendent to the effect that the *construction* of the state statute by the Missouri Supreme Court will be followed by this court, is not questioned. But whether the statute, or the order, or both, as thus construed, *violate the Federal Constitution* are clearly questions for this court's determination.

II.

The decision below does not rest upon independent non-federal grounds. The federal rights asserted were of such character that no judgment adverse to petitioners could be rendered without denying them; and they were necessarily denied by the result of the opinion and judgment below.

Under the second point in his brief (pages 20 to 24) the Superintendent argues in effect that the decision by the Missouri Supreme Court rests entirely upon non-federal grounds broad enough to support it and that therefore this court is without jurisdiction to review it.

1. The principle invoked is without application here. In this case petitioners asserted rights under the Federal Constitution of such character that no judgment against petitioners on the merits could possibly be rendered without denying them. Petitioners asserted that the rate reduction order and the Rating Act as construed and applied were in certain respects confiscatory and unconstitutional, and that petitioners were thereby deprived of their property without due process of law. The Missouri Supreme Court by its judgment upon the merits has sustained the rate reduction order as valid under the statute, thereby necessarily holding against petitioners upon the federal questions presented. In such case the decision does not rest upon independent non-federal grounds. The federal questions continue to be live questions in the case, and this court has jurisdiction to review them.

2. It is quite true the Missouri Supreme Court did not *expressly refer* to the federal questions. But this is not material. That court necessarily decided the federal questions against petitioners by the result reached. Federal questions, seasonably asserted and kept alive

throughout the proceeding below, cannot be deleted from the case by the mere failure of the Missouri Supreme Court to pass upon them in specific terms. If it were otherwise, a federal question could always be eliminated by mere silence on the part of the state court.

In *Chicago, Burlington & Quincy Railroad* v. *Chicago*, 166 U. S. l. c. 231-232, this court said:

> "It is true that the Supreme Court of Illinois *did not in its opinion expressly refer* to the Constitution of the United States. But the circumstance is not conclusive against the jurisdiction of this court to re-examine the final judgment of the state court. *The judgment of affirmance necessarily denied the Federal rights thus specially set up by the defendant; for that judgment could not have been rendered without deciding adversely to such claims or right.* Those claims went to the very foundation of the whole proceeding so far as it related to the railroad company, and the legal effect of the judgment of the Supreme Court of the State was to deny them. * * * Consequently, the motion to dismiss for want of jurisdiction must be overruled, and we proceed to examine the case upon its merits." (Italics ours.)

To the same effect are the following:

Chicago, Burlington & Quincy Ry. Co. v. *Drainage Comms.*, 200 U. S., l. c. 580.

West Chicago Railroad v. *Chicago*, 201 U. S., l. c. 519.

Schlemmer v. *Buffalo, Rochester Ry. Co.*, 205 U. S., l. c. 11.

Chicago Life Ins. Co. v. *Needles*, 113 U. S., l. c. 579.

International Harvester Company v. *Missouri*, 234 U. S. 199.

Green Bay Canal Co. v. *Patten Paper Co.*, 172 U. S., l. c. 66-68.
McCullough v. *Virginia*, 172 U. S., l. c. 116-117.
Kaukauna Co. v. *Green Bay & Canal Co.*, 142 U. S., l. c. 269.
Eureka Lake Co. v. *Yuba Co.*, 116 U. S. 410.
Toledo, etc., Ry. Co. v. *Slavin*, 236 U. S. 454.
Carondelet Canal Co. v. *Louisiana*, 233 U. S. 362.
Otis Co. v. *Ludlow Mfg. Co.*, 201 U. S. 140.

It should be noted that in every case quoted in the Superintendent's brief on this point it is stated in substance that it is sufficient to give this court jurisdiction if the "judgment as rendered could not have been given without deciding the federal question." This is a recognition of the proposition for which we contend.

3. The federal questions presented were fundamental in their nature, going to the very foundation of the judgment. Petitioners in several respects attacked the very basis and methods of calculation adopted by the Superintendent in arriving at profit. The majority opinion of the Missouri Supreme Court brushed aside the constitutional questions without even mentioning them, yet upheld the Superintendent's rate reduction order and methods of calculation. Obviously, the federal rights asserted were necessarily denied. This court, therefore, has jurisdiction to review the judgment.

III.

The questions which petitioners present herein are not questions of fact, but are questions of law, the decision of which this court has jurisdiction to review.

Under the third point in his brief (pages 24-26) the Superintendent argues that all of the questions involved in this case are questions of fact, and that this court has no jurisdiction to review the Missouri Supreme Court's decision on questions of fact. In support of his contention the Superintendent says: "Whether they (the petitioners) made a profit or loss was purely a question of fact, and the Missouri Supreme Court after considering the testimony of both sides found in favor of the State of Missouri."

1. This argument begs the question. While the *ultimate* question is whether petitioners made a profit or loss, yet before that question is reached there are presented these vital questions: (a) whether the adoption of the received and paid method of calculating underwriting profit is unreasonable, fundamentally erroneous and confiscatory; (b) whether the application of investment earnings toward a reduction of underwriting rates is confiscatory; (c) whether the disallowance of excess commissions as an item of expense is unreasonable and confiscatory; (d) whether the disallowance of the war tax as an item of expense is unreasonable and confiscatory; (e) whether the fixing of eight per cent of premiums received as the amount of a reasonable profit, without making allowance for the unearned premium reserve, is unreasonable and confiscatory; (f) and whether the rating statute as construed and applied is in violation of the due process clause. *These questions are pure questions of law, and not questions of fact in any sense.*

2. In a number of cases, rates established by state rate-making bodies, upheld by state courts of last resort, have been reviewed and the judgments of the state courts reversed by this court because of unreasonable or fundamentally erroneous methods used in calculating profit or loss, which this court held to be confiscatory and a denial of due process. These decisions necessarily were based upon questions of law, not questions of fact. If the question whether a profit or loss has been derived from a given rate structure, involving inquiry into the methods of calculation employed, is purely a question of fact (as the Superintendent argues), then this court would never have jurisdiction to review the judgment of a state court in any rate case. It would always be open to the state rate-making body to forestall the review upon the ground that the state court's judgment is conclusive because based on findings of fact. In the following cases judgments of state courts upholding confiscatory rates were reversed by this court upon the point of law above stated:

Bluefield Water Works & Improvement Company v. *Public Service Commission*, 262 U. S. 679.

State of Missouri ex rel. Southwest Bell Telephone Company v. *Public Service Commission*, 262 U. S. 276.

Northern Pacific Railway v. *Department of Public Works*, 268 U. S. 39, l. c. 44.

Ohio Utilities Co. v. *Public Utilities Commission*, 267 U. S. 359.

Vandalia Railroad Company v. *Schnull*, 255 U. S. 113.

Northern Pacific Railway Co. v. *North Dakota*, 236 U. S. 585.

Norfolk & Western Railway Co. v. *Conley*, 236 U. S. 605.

It is interesting to note that in *State of Missouri ex rel. Southwest Telephone Company* v. *Missouri Public Service Commission*, 262 U. S. 276, the Missouri Public Service Commission made identically the same argument as that made by the Superintendent here, namely, that the Missouri Supreme Court had found the rates were not confiscatory, and that this was a *finding of fact* which this court should not review (see 262 U. S., l. c. 280). Nevertheless, this court did review the judgment, and reversed it on the ground, among others, that an item of legitimate expense had been unreasonably disallowed by the Commission (262 U. S., l. c. 288-9).

3. The question as to proper method of calculating underwriting profit was treated as a question of law in *Bullion* v. *Aetna Insurance Company*, 151 Ark. 519, 237 S. W. 717; *Sun Insurance Office* v. *Clark*, App. Cas., Law Reports 1912, page 443; *Scott* v. *Eagle Fire Company*, 7 Paige (New York) 198; and *Hope Mutual Insurance Company* v. *Perkins*, 4 Rob. (New York) 182. The rule for ascertaining profit or loss stands in the same status as the rule for ascertaining damages, which is treated as a question of law (*Christian* v. *Irwin*, 125 Ill. 619).

In the *Bullion Case* (237 S. W., l. c. 723), Justice Wood in his concurring opinion said:

> "Even if there had been no testimony in the record explaining the meaning of the technical term 'underwriting profit,' this court applying business principles and correct rules of accounting could have only reached the same conclusion without the aid of the testimony of insurance rate experts, that it has arrived at with such aid."

This is a clear holding that the question is one of law.

4. The Missouri Supreme Court expressly finds in its opinion in this case that the facts are undisputed (R. 3008-9). In such a case the only questions presented are questions of law. (*Small Co.* v. *Lamborn & Co.*, 45 Sup. Ct. Rep., l. c. 303; *Bell* v. *Carter*, [C. C. A.] 164 Fed. 417; *Muskogee Land Co.* v. *Mullins*, [C. C. A.] 165 Fed. 179; *Harmon* v. *Barber*, [C. C. A.] 247 Fed., l. c. 5-6; *Hammerschlag Mfg. Co.* v. *Traders Bank*, [C. C. A.] 262 Fed. 266.)

The facts being undisputed, the situation is analogous to that presented where the facts alleged in a petition are admitted by demurrer. In such a case this court has recently said in *Truax* v. *Corrigan*, 257 U. S., l. c. 324:

> "The facts alleged are admitted by the demurrer, and in determining their legal effect as a deprivation of plaintiffs' legal rights under the Fourteenth Amendment, we *are at as full liberty to consider them as was the State Supreme Court*. *Mackay* v. *Dillon*, 4 How. 421; *Denver* v. *Richards*, 151 U. S. 658, 667. Nor does the court's declaration that the statute is a rule of evidence bind us in such an investigation. *Bailey* v. *Alabama*, 219 U. S. 219, 239; *Chicago, Milwaukee & St. Paul Ry. Co.* v. *Minnesota*, 134 U. S. 418; *Mugler* v. *Kansas*, 123 U. S. 623, 661; *Corn Products Refining Co.* v. *Eddy*, 249 U. S. 427, 432. In cases brought to this court from state courts for review, on the ground that a federal right set up in the state court has been wrongly denied, and in which the state court has put its decision on a finding that the asserted federal right has no basis in point of fact or has been waived or lost, this court as an incident of its power to determine whether a federal right has been wrongly denied, may go behind the finding to see whether it is without substantial support. If the

> rule were otherwise, it almost always would be within the power of a state court practically to prevent a review here." (Italics ours.)

To the same effect, see *Kelley* v. *Rhoads*, 188 U. S., l. c. 5.

5. The Missouri Supreme Court has not found *the facts* against the petitioners. But even if it had done so, it has been clearly ruled by this court in a number of decisions that where it is necessary for this court, in passing upon a federal right asserted, to analyze the facts in order to determine whether that which purports to be a finding of fact is so interwoven with a question of law as to be in substance a decision of the latter, this court will go into the facts for that purpose. For example, in *Norfolk & Western Ry.* v. *Conley*, 236 U. S., l. c. 609-610, this court said:

> "So far as findings are concerned, we have in the present case simply a general, or ultimate, conclusion of fact which is set forth in the decree of the state court; and it is necessary for us, in passing upon the federal right which the plaintiff in error asserted, to analyze the facts in order to determine whether that which purports to be a finding of fact is so interwoven with the question of law as to be in substance a decision of the latter."

The same principle is announced in the following cases:

Crescall v. *Knights of Pythias*, 225 U. S., l. c. 261.

Oregon Railroad and Navigation Co. v. *Fairchild*, 224 U. S., l. c. 528.

Southern Pacific Co. v. *Schuyler*, 227 U. S., l. c. 611.

Wood v. *Chesborough*, 228 U. S., l. c. 678.
Acme Harvester Co. v. *Beekman Lbr. Co.*, 222 U. S., l. c. 305-6.

6. In the apparent effort to confuse the issue upon this point the Superintendent says at page 24 of his brief: "The state questioned every one of their (the petitioners') figures and held that they had attempted to mislead the state." This statement of the Superintendent must not be construed to mean that there is any controversy over the figures upon which this case was tried, for these figures were *specifically accepted as correct by the state* during the trial (R. 2072), and are found by the opinion below to be *undisputed* (R. 3008-9, 3011); but the statement must be read in connection with what immediately follows, wherein the Superintendent says: "They were compelled by law to file sworn reports with Missouri each year showing their income and outgo, but when this case came on for trial they presented an entirely new set of figures much more to their advantage, so that it was purely a question of fact as to which set of figures was correct."

This contention, in the light of the record, is utterly preposterous. The reports to which the Superintendent refers were the so-called "Reports of Underwriting Experience by Classes." The blanks upon which these reports were made were prepared by someone in the Insurance Department who evidently had a very hazy idea of exactly what information was desired. The blanks were ambiguous, misleading and incomplete, covering only a portion of the classes of business written by the petitioners; they varied, in that the information and data called for was different from year to year; and as a result of their admittedly incomplete and con-

fusing form, the amounts of premiums, losses and expenses reported in such blanks were not the same as the amounts of premiums, losses and expenses upon which this case was tried. But obviously they could not be the same, because the underwriting blanks called for information as to only *a part* of the classes of insurance written, and not *all* classes; whereas the figures in evidence upon which the case was tried included *all classes*. Therefore necessarily the two sets of totals could not possibly correspond (R. 1855-1908, 196-7, 380-6, 387-393, 443-6, 535-6, 603-7, 668-9, 675, 2083-5, 2273).

It is an untrue statement of the issue presented to say that it was "purely a question of fact as to which set of figures was correct." *Neither side contended that the figures reported in the "Reports of Underwriting Experience by Classes" could be a proper predicate for the determination of this case.*

Clearly the record presents federal questions of law, which this court has jurisdiction to review.

IV.

Petitioners have substantial property in Missouri, and they are entitled to invoke the protection of the Fourteenth Amendment.

Under Point IV of his brief (pages 27-30) the Superintendent argues that petitioners have no property in Missouri and that they are not entitled to the protection of the Fourteenth Amendment. And at page 20 he says petitioners "had no property in the state, but simply exchanged contracts of insurance for money."

1. Apparently the position of the Superintendent is that even if the rate reduction order is confiscatory, so

that petitioners are required to write insurance at less than cost, yet the Fourteenth Amendment affords them no protection against such confiscation. This argument discloses the genuine viewpoint of the Superintendent, which is sealed with the approval of the Missouri Supreme Court, namely, that the insurance companies have no rights which Missouri is bound to respect; and that under the guise of regulation Missouri may require the writing of insurance at rates productive of income insufficient to meet outgo.

Of course, if this may constitutionally be done, then the insurance companies could be required to write their policies for mere nominal considerations, or for no consideration at all; for this would only be carrying to a greater degree the same principle, that the insurance companies have no rights which Missouri is required by the Fourteenth Amendment to recognize.

We had supposed this notion had long since been dispelled by the decisions of this court in *Terral* v. *Burke Construction Co.*, 257 U. S. 529; *Fidelity & Deposit Co.* v. *Tafoya*, 46 Sup. Ct. Rep. 331; *Carroll* v. *Greenwich Insurance Co.*, 199 U. S., l. c. 409, and similar decisions.

2. Foreign corporations are "persons" within the meaning of the due process clause.

Kentucky Finance Corporation v. *Paramount Auto Exchange Corporation*, 262 U. S., l. c. 550.
Santa Clara County v. *Southern Pacific R. R. Co.*, 118 U. S., l. c. 396.
Covington & Lexington Turnpike Co. v. *Sandford*, 164 U. S., l. c. 592.
Smyth v. *Ames*, 169 U. S., l. c. 522.
Atchison, Topeka & Santa Fe Ry. Co. v. *Vosburg*, 238 U. S. 56.

3. Petitioners have established their agency plants and business in Missouri at great cost and expense (R. 1531-2, 749). These agency relations and established business are of great pecuniary value. The actual salable value of agency plants is shown to be twenty-five per cent of the amount of unearned premiums (R. 1760-1, 1802-3). The unearned premiums in Missouri at the end of the five year test period were $17,061,209 (plaintiffs' Exhibit 1359 at R. 1925). Twenty-five per cent of this sum is $4,265,302, which was the value of petitioners' agency plants in Missouri at the end of the test period as shown by the evidence.

These agency plants represent something in addition to mere "good will." They consist of agency relations with chosen experts, equipped with offices and paraphernalia necessary for the business. Policyholders have acquired the habit of renewing their policies with the same companies so that what is termed "expirations" are of great value to the companies. Even the interest of the local agents of the companies in these expirations is regarded as property of a well recognized value, is subject to sale and is protected by the courts.

> *Barber* v. *Conn. Mut. Life Ins. Co.*, 15 Fed. 312.
> *National Fire Insurance Co.* v. *Sullard*, 89 N. Y. Supp. 934.

That "good will" alone is property and subject to protection as such is settled by all of the authorities.

> *Crutwell* v. *Lye*, 17 Vesey 335 (opinion by Lord Eldon).
> *Washburn* v. *Nat. Wall Paper Co.*, 81 Fed. 17.
> *See* v. *Heppenheimer*, 61 Atl. (N. Y.) 843.
> *Rowell* v. *Rowell*, 99 N. W. (Wis.) 478.
> *Godley* v. *Crandall*, 139 N. Y. Supp. 236.

Milling Co. v. *Hanebrink*, 247 Mo., l. c. 221.
Clabaugh v. *Heibner*, 236 S. W. 396.
Bettendorf v. *Bettendorf*, 190 Iowa 83.
Lindeman v. *Rusk*, 125 Wis. 210.
Langer v. *Fargo Merc. Co.*, 186 N. W. 104.

This court in *Des Moines Gas Co.* v. *Des Moines*, 238 U. S. l. c. 165, said:

> "'Going value,' or 'going concern value,' i. e., the value which inheres in a plant where its business is established, as distinguished from one which has yet to establish its business has been the subject of much discussion in rate-making cases before the courts and commissions. Many of those cases are collected in Whitten on 'Valuation of Public Service Corporations,' Secs. 550-560, and the supplement to the same work, Secs. 1350-1385. That there is an element of value in an assembled and established plant, doing business and earning money, over one not thus advanced, is self-evident. *This element of value is a property right* * * *" (Italics ours.)

And in *Denver* v. *Denver Water Co.*, 246 U. S., l. c. 192, this court re-affirmed the same principle.

4. The case of *Galveston Co.* v. *Galveston*, 258 U. S. 388, is cited by the Superintendent in support of the proposition that good will can not be considered in determining whether a rate is confiscatory. In that case, this court held merely that "going concern value and development cost, *in the sense in which the master used these terms*, are not to be included *in the base value* for the purpose of determining whether a rate is confiscatory." This court said that the master could not have meant by this to cover the cost of establishing the system as a physically going concern, for that cost had already been allowed in the historical value by items

including expenses of organization and business management (p. 393). The going concern value for which the master made allowance was "the cost of developing the operating railway system into a financially successful concern." That was estimated by various calculations based on theories of what past deficiencies in net income would aggregate, thus erecting out of past deficits a legal basis for holding confiscatory, for the future, rates which would on the basis of present reproduction value, otherwise be compensatory. This court held merely that a fund could not be created out of past deficits and added to the base value.

But in the Galveston case this court not only recognized that *good will is property, but said that it is often a more important element of value than tangible property*, and that compensation must be made for it under certain circumstances, citing as examples, *Omaha* v. *Omaha Water Co.*, 218 U. S. 180, and other cases (page 396 of opinion).

In the case at bar there is no question whether "good will" should be valued and added to a *rate base*. The question here is whether agency plants are property subject to the protection of the Fourteenth Amendment. That involves merely the question whether they are *property*. The Galveston case and the other cases above cited hold that good will is property. Certainly agency plants, the stock in trade of the companies, are property of very great value and entitled to the protection of the Fourteenth Amendment.

5. If the reduction order violates the Fourteenth Amendment in that it prevents the companies from doing business at a reasonable profit, then that order is no more binding on the companies than was the New Mexico statute involved in *Fidelity & Deposit Co.* v.

Tafoya, 46 Sup. Ct. Rep. 331, which provided for the suspension of the licenses of insurance companies upon failure to comply with a statute held to be violative of the Fourteenth Amendment. In that case deprivation of property was complained of by a foreign insurance company, and this court did not hesitate to give the insurance company the protection of the Fourteenth Amendment.

6. Petitioners are not law violators or outlaws. They are expressly chartered, licensed and permitted to do business in Missouri. Yet the Superintendent says that so far as the Fourteenth Amendment is concerned the State of Missouri can compel them to do business without profit, because their established business and agency plants (worth over $4,000,000) are not property. The absurdity of this contention seems evident. The Superintendent in effect charges that petitioners' established business exists only in the making of contracts, without tangible property, and that therefore the capital and surplus of the petitioners' stockholders may (so far as the Fourteenth Amendment is concerned) be confiscated to furnish cheap insurance to the citizens of Missouri.

If the petitioners are compelled to do business at a loss in Missouri, then to pay their expenses and the losses which they contract to pay they must use their capital or their surplus, which belong to the stockholders; and if that is not a deprivation of property within the case of *Smyth* v. *Ames*, 169 U. S. 526, and cases following it, we are at a loss to know what could be a deprivation of property.

In *Truax* v. *Corrigan*, 257 U. S. 1, c. 328, this court has held that *to injure one's established business* is to deprive one of *property* within the meaning of the Fourteenth Amendment.

7. The argument of the Superintendent (page 30 of his brief) that insurance companies may "leave the state at any time they see fit and sustain no loss" is obviously not true. Having established their business at great expense, they would sustain enormous loss by leaving.

8. At page 30 of his brief the Superintendent cites *Merchants Mutual Automobile Insurance Co.* v. *Smart*, 267 U. S., l. c. 130, holding that a certain statute did not deprive an insurance company of property without due process of law. In that case the state statute required that any automobile liability policy issued in the future to indemnify an automobile owner against liability to persons injured through negligence in its operation, should include a provision that the insolvency of the assured should not release the insurance company from payment of damages to the injured person. The company in that case had incorporated this provision in its policy. This court held that the requirement of the statute was reasonable and that it could not be said to deprive the insurance company of its property without due process of law. Obviously, that case is distinguishable from this. In that case it was entirely *optional* with the insurance company whether it would write policies in New York *with knowledge that such a statute was in effect;* and in that case *it voluntarily chose to insert the provision in its policy*. If the company chose to issue policies with such a statute in effect, and to issue them in accordance with the statute, obviously its assumption of liability was voluntary, and it could not be heard to complain that it was deprived of its property without due process. That decision does not aid the position of the Superintendent in the instant case, in his argument that the insurance companies have no property in Missouri within the protection of the Fourteenth Amendment.

9. At pages 29-30 of his brief the Superintendent cites *Northwestern National Life Insurance Co.* v. *Riggs*, 203 U. S., l. c. 255, holding that the "liberty" referred to in the Fourteenth Amendment is the liberty of natural, not artificial, persons. Mr. Justice Harlan's opinion in that case was undoubtedly predicated upon a restricted definition of the word "liberty," as meaning freedom from servitude or physical restraint. In this restricted sense of the word "liberty," it can apply of course only to natural persons.

Since that decision this court has distinctly held that the "liberty" mentioned in the Fourteenth Amendment means not only the right of the citizen to be free from the mere physical restraint of his person, as by incarceration, but the term is deemed to embrace freedom of contract and the right to pursue any lawful business. (*Chicago, Burlington & Quincy R. R. Co.* v. *McGuire*, 219 U. S., l. c. 566-567; *Smith* v. *Texas*, 233 U. S., l. c. 636; *Wolff Packing Co.* v. *Industrial Court*, 262 U. S., l. c. 534; and see *Adair* v. *U. S.*, 208 U. S. 161, construing the word "liberty" in the same way as used in Fifth Amendment.) It is clear from the language used in *Chicago, Burlington & Quincy R. R. Co.* v. *McGuire*, *supra*, and *Wolff Packing Co.* v. *Industrial Court*, *supra*, that this court considers liberty of contract as guaranteed to artificial as well as natural persons.

If in the present case there is a deprivation in that petitioners are limited in the making of "contracts of insurance for money" (quoting from page 20 of the Superintendent's brief), then their liberty of contract is infringed, resulting in a deprivation of property. In *Smith* v. *Texas*, 233 U. S. 630, this court said:

> "Life, liberty, property * * * grouped together in the Constitution are so related that the

deprivation of any of those separate and independent rights may lessen or extinguish the value of the other three."

We respectfully submit that petitioners have substantial property in Missouri; and that the Fourteenth Amendment protects them from the confiscation of this property without due process of law.

V.

As to the Superintendent's suggestion that the effect of the reduction order be further tested.

At pages 31-34 of his brief the Superintendent argues that even if federal questions are involved, this court should not interfere, but should permit the rate reduction order to be "tested out before being declared confiscatory and void." The answer to this argument seems obvious:

1. The Rating Act itself (Sec. 6283 R. S. Mo. 1919) provides for a test—a five year test. The Missouri Supreme Court has so construed it in this case. The rate level which was in effect before the Superintendent's reduction order was made has already been tested by the experience of the years 1917 to 1921 inclusive. Thousands of pages of testimony have been taken in the instant case showing the result of that five year test. The old rate level has been shown to be too low to permit petitioners to operate at a profit. A reduction in rates would necessarily subject petitioners to still greater loss. There is therefore no justification for the Superintendent's suggestion that the effect of the reduction order should be *further* tested.

2. The Superintendent's suggestion completely overlooks the point that the only source of authority for any

regulation of rates in Missouri is Sec. 6283, which expressly predicates the power to regulate upon the experience of the past five years. It is only when the experience of the past five years justifies it, that rates may be reduced at all. It is manifest that the experimental *further* test suggested by the Superintendent could not possibly throw any light upon the *only material question*, namely, whether in the *past five year period* the insurance companies made an inordinate profit.

3. If the Superintendent's suggestion were followed, petitioners would be subjected to ruinous loss. They would be compelled to return to Missouri policyholders approximately $7,000,000, representing the difference between the old rate level and the reduced rate level. This gigantic sum would be irrevocably lost to them.

4. Suppose for the sake of argument, the effect of the reduced rate level were subjected to a *further* test as the Superintendent suggests; and suppose the result of that further test should be to subject petitioners to still greater loss than they have already sustained. What would be petitioners' remedy in the event the Superintendent should decline to grant an increase in rates? The Missouri Supreme Court has held in *State ex rel. Waterworth v. Harty*, 278 Mo. 685, that the Missouri Rating Act does not give the insurance companies any right of action to compel the Superintendent to approve an *increase in rates*. Under that decision the petitioners in such a case would be at the absolute mercy of the Superintendent, and wholly without remedy to compel him to grant an increase.

Petitioners' only avenue of escape from confiscation is by a review of the judgment in the instant case by this court.

There is no warrant for accepting the Superintendent's wily suggestion that the effect of the reduction order be further tested.

VI.

As to the proper method of calculating underwriting profit.

1. In support of his argument in favor of the received and paid method of calculating underwriting profit the Superintendent says at page 36 of his brief:

> "Four presidents of the largest fire insurance companies in America testified that the calculation of profit or loss could not be made upon the basis of earned premiums, incurred losses and expenses, as contended for by these insurance companies."

Seven record pages are cited as indicating the places in the record supposed to sustain this extravagant statement.

The first record page cited is page 408, which is the testimony of F. G. Bush, an accountant and not a president of a company; and it will be found that his evidence, as there appearing, does not remotely support the statement of the Superintendent.

The next record citation is page 722, which refers to the testimony of witness O. E. Lane, President of Niagara Fire Insurance Company. This witness states that his company uses earned premiums, incurred losses, and paid expenses (R. 698-9, 722). As we pointed out in our original brief (p. 13), the difference between paid and incurred *expenses* is negligible, and a number of witnesses

make no effort to use incurred expenses, because the paid figure serves their convenience and there is no substantial difference between the two. The record at the page cited in no way supports the statement of the Superintendent above quoted.

The next record citation is R. 1146, which is a part of the evidence of witness E. C. Jameson, president of Globe & Rutgers Fire Insurance Company. This witness, by inadvertence, did state at the page mentioned that written premiums formed a proper basis for profit calculation. The Superintendent fails to point out, however, that this witness corrected his statement and later stated explicitly that *earned* premiums formed the proper basis and that if he had previously said written premiums, it was through inadvertence (R. 1173).

The next record page cited by the Superintendent is R. 1190 (witness West). The use of the term "premiums received" was contained in counsel's question and not in the witness's answer, but the question and answer combined convey the impression that the witness approved of the received and paid basis. Counsel for the Superintendent fail to call the attention of this court to the fact that the same witness (R. 1205) corrected his testimony and, when his attention was called to the fact that he had used the term "premiums received" in stating the proper basis for profit calculation, answered:

> "Well, I am inclined to think I may have said that hastily. What I meant, of course, was premiums *earned*. There is nothing in this 'premiums received.' We, in insurance parlance, always talk of premiums *earned*, because on premiums received it doesn't mean anything at all." (Italics ours.)

The next record page cited is R. 1211, where the same witness, further testifying, says in speaking of the *earned* premium method after giving the detail of its computation:

> "Q. Now, that is the process. Well, now, you say that should furnish the basis of calculation for rates? A. Yes, sir."

The witness's evidence at this page clearly states that the earned premium method is correct and not the contrary, as counsel state in their brief.

The next record citation is R. 1293. This is a reference to the evidence of Frederick Buswell, vice-president of the Home Insurance Company, who, far from stating that the premium received basis was proper, testified at the page cited:

> "Q. In determining whether or not you have made a loss or profit in a given state in a given period, can you tell me how you ascertain that fact? A. Yes, losses incurred and expenses, and the increase or decrease in the unearned premium reserve."

This is an explicit approval of the earned premium method and not the premium received method.

We respectfully submit that there is no evidence whatsoever in the record to support the statement of the Superintendent that "four presidents or any other number of presidents or officers of insurance companies testified as he says they did.

2. At page 36 of his brief the Superintendent says: "All the reports filed by these insurance companies with the State were on the basis of premiums received, losses and expenses paid (R. 1198)." There is nothing on page 1198 of the record which even remotely approaches this subject. The record is uncontradicted that the annual

statements filed by all companies with the State of Missouri include a report of the nation-wide business of the respective companies upon the earned and incurred basis. *This fact is indisputably shown by a sample copy of the annual statement blank itself at page 1285-7 of the record.*

3. At page 36 of his brief the Superintendent says: "These insurance companies helped prepare the Rating Act and agreed to the method of premiums received, losses and expenses paid (R. 2300-2305)." The testimony fails to show that when the Rating Act was drafted there was any discussion one way or the other as to the proper basis of calculating underwriting profit (R. 2305-6).

4. At page 36 of his brief the Superintendent says that on two previous occasions the insurance companies applied for and received an increase in rates on the received and paid basis. It is true that the insurance companies, deferring to the position taken by the Insurance Department, applied for an increase of rates and submitted their underwriting experience upon the received and paid basis. However, the record discloses the reason for this: The received and paid basis had been adopted by the Insurance Department since the recent enactment of the Rating Act in 1915 (R. 2302, 2744, 2837-8), and the Insurance Companies chose to deal with the Department upon its own basis; and even upon such basis, which was more favorable to the State than the earned and incurred basis would have been, the companies were actually found entitled to the increases asked (R. 2835, 2330-3). However, as pointed out in our original brief, the Superintendent cannot justify a confiscatory rate on the ground that the insurance companies by their former conduct have become estopped from charging a compensatory rate (*Southern Pacific Company* v. *Interstate Commerce Commission*, 219 U. S. 433).

5. At page 37 of his brief the Superintendent says: "Such method (the earned and incurred method) was adopted by these companies for the first time in Missouri upon the filing of this lawsuit because it works to their advantage and is unfair to the state." This erroneous statement of fact has been answered in our original brief (page 44), to which we respectfully refer.

6. At page 37 of his brief the Superintendent says: "To allow these insurance companies profit on this new method of theirs (the earned and incurred method) means a return to the stockholders of at least 600 per cent (R. 895.)" This assertion is entirely unsupported by the record. The court will find at the page of the record cited, that the Superintendent's counsel sought to make a 600 per cent profit appear as to one specified company, and the witness stated that, assuming the correctness of the statement, it failed to take into account that another company under the same management had conducted business at a loss. None of these inquiries related to the business of either company in Missouri, or to the aggregate experience of all the companies in Missouri; and the Superintendent's statement that such is its effect is without support in the evidence.

While obviously the amount of return to stockholders upon the companies' nation-wide business as a whole (including earnings from investments) is not material or relevant in this case, which involves only the fixing of a rate level in Missouri for underwriting, yet the fact is that upon the nation-wide business as a whole of all the petitioners during the five-year period the cash dividends were only *6.39 per cent* of capital and surplus, and the cash dividends plus accretions to surplus were only *10 per cent* of capital and surplus (R. 1361-4, 1369). In the face of this undisputed fact, the reckless extravagance

of the Superintendent's suggestion of a possible *600 per cent* profit becomes manifest.

7. At page 3 of his brief the Superintendent says that "the Insurance Department has never been in possession of sufficient facts to allow it to figure the experience of these companies on any other basis" than the received and paid basis. As pointed out at page 47 of our original brief, Sec. 6281, R. S. Mo. 1919, requires the insurance companies to report to the Superintendent *such information as he may require;* so the Superintendent has full power to require a report of Missouri experience upon the earned and incurred basis, if he desires it. He may require the reporting of premiums received, premiums earned, or both, at his will.

8. At page 2 of his brief the Superintendent erroneously says that "the *Legislature* requires the insurance companies to report their business on the basis of premiums received, losses and expenses paid." The Superintendent does not correctly state the requirements of the statute. The statutes require the companies to make an "annual statement" (see page 67, appendix of petitioners' original brief), in which report the nation-wide underwriting experience is reported on the *earned and incurred basis* (R. 187-190, 863, 228, 232, 709, 1371, 1536-7, 2141-2, 2204, 2295, 2806-7). The reports to which the Superintendent refers are what are known as the "Reports of Underwriting Experience by Classes," which are not prescribed by *statute* at all, but are prepared and sent out by the *Superintendent* under the general power given him in Section 6281, R. S. Mo. 1919, to require a report of such matters "as the Superintendent of Insurance may require." It is accurate to say that the *Superintendent* has required the report of *a part* of petitioners' Missouri experience on the re-

ceived and paid basis. It is *not* accurate to say that the *Legislature* has required the report of petitioners' Missouri experience upon the received and paid basis for rate making purposes.

9. We shall pass by the unsupported statement of the superintendent (page 4) where he states that "the evidence was absolutely overwhelming that the State's method of figuring was right," and other superlatives used throughout his brief, *as to which he does not cite the record;* and we assume this court will not be influenced by such unsupported statements.

10. Purely to obviate confusion, we call attention to the two sets of premium figures stated by the Superintendent at page 4 of his brief. He speaks of the premium figure as $83,502,181 at one place, and as $77,897,768 at another place in the same paragraph. It should be explained that the larger figure is the amount of all premiums received during the five year period in Missouri, as shown by the evidence. The smaller figure is the amount of all premiums shown for the same period in the so-called "Reports of Underwriting Experience by Classes," which covered *only certain classes* and not all of the business, *and therefore have no bearing whatever upon the issues before the court.* The statement by the Superintendent (page 4 of brief) that "the figures in this law suit show a smaller profit than reported to the state by such sworn reports" is entirely misleading in this particular. The experience, in fact, upon the entire insurance business of petitioners upon the earned premium basis is shown in the exhibits at page 1925 of the record, the recapitulation of which appears in plaintiffs' Exhibit No. 1359. The experience for the period upon the received and paid basis upon all classes appears in the record at page 1934, recapitulation thereof being plaintiffs' Exhibit No. 1361. The written

premiums, it will be noted in these exhibits, are shown as $83,502,181. The Reports of Underwriting Experience by Classes cover only what the witness McGee calls "regulated classes," and omit many classes of business written by the petitioners (R. 2056).

As these Reports of Underwriting Experience by Classes did not include all the classes of business transacted by petitioners in the State of Missouri but only part of them, and the blanks prepared by the state were confusing and differently interpreted by various companies making returns, resort to them was fruitless, and they did not form the basis upon which the case was tried. *In fact, they have nothing to do with the case whatever, except as the Superintendent may seek to obscure the facts by talking about them.* He says of them (page 5 of his brief):

> "In fact, the record convicts the companies of having made improper and false reports to the state of Missouri for the sole purpose of influencing the state in regulating fire insurance rates."

The record is not cited in support of this surprising statement; there is not a scintilla of evidence in the record to sustain it. In our original brief (at page 10) we have called attention to these reports and cited the court to the pages of the record where full explanation appears for the discrepancies in them, including admissions of the Superintendent (R. 2273) and his chief witness (R. 2083-5), that the defects in the report blanks were such as to necessarily lead to improper figures.

11. The Superintendent states (page 6 of his brief) that the earned premium method is fundamentally erroneous and cites pages of the record to substantiate the state-

ment. It will be found on examination that they do not sustain it.

12. At page 7 of his brief the Superintendent says that the unearned premium reserve "can be carried just as well by using the method of premiums received as by using the method of premiums earned." May we ask how this could possibly be done? Under the received and paid method the unearned premiums are treated as accrued income, that is, as the *unqualified property* of the petitioners. How then, logically, can the unearned premium reserve (a liability) be set up out of premiums which have already been treated as accrued income and as the *unqualified* property of petitioners? The statute requiring the setting up of the reserve as a liability (Sec. 6222, R. S. Mo. 1919) is consistent only with the use of the earned and incurred method of calculating underwriting profit.

13. The Superintendent seeks to distinguish the cases cited by petitioners in support of the earned premium method, and particularly the Sun Insurance Office case, by saying that in case of such tax exactions "it all ultimately washed out because ultimately all of the income would be taxed" (page 8 of brief). The situation is identical in the question here before the court; for the portion of the premiums written during the five year test period which are unearned during that period become earned during the next succeeding period, and then are treated as income; and as each year elapses a new five year period may be selected as a test—namely, by rejecting the first year of the period previously used and adding a new year. Such method in each five year period takes into account all earned premiums arising from the next previous period.

14. At page 9 of the Superintendent's brief he says it is "a curious fact" that petitioners state that expenses incurred and expenses paid are substantially the same (being normally about 42 per cent of premiums); and that notwithstanding this petitioners also state that the agency commissions are 22 to 25 per cent and "usually only the agent's commission is paid in the year in which the business is written." He calls these "diametrically opposed statements." The statements are not in any way opposed. While upon a particular policy or group of policies written in a given year the acquisition expense of 22 to 25 per cent is substantially all that is paid on that year's writings, yet there would be incurred and paid during such year taxes and other charges upon business written during the preceding year, as taxes in general are payable the year after business is written. These expenses incurred and paid during a given year, while charged against the year's business, nevertheless are an outgrowth of business written during a previous year. There is no contradiction in the statements of petitioners in this respect.

15. At page 10 of his brief the Superintendent says: "This 10 per cent reduction which they (the petitioners) complain about is not a reduction at all, but really a 5 per cent increase, for the reason that in 1920 these companies were granted an increase in rates of 15 per cent, and in 1922 this reduction of 10 per cent was ordered, so that in the future the companies will still have a 5 per cent increase over the rate in effect during the period from 1917 to 1921 inclusive, after the 10 per cent reduction is in effect." As a matter of fact, the Superintendent's evidence shows that the January, 1920, increase in rates was a 15 per cent increase applicable to only 71 per cent of the business written (R. 2060), yet notwithstanding this in-

crease, which was reflected in the experience of the last two years of the test period, the experience of the five years showed an underwriting loss in Missouri of $7,010,200 on the earned and incurred basis (R. 3018, 3007). Obviously the 10 per cent reduction would only serve to increase this sustained loss.

The argument of the Superintendent proceeds upon the mistaken assumption that whether an experience is profitable or unprofitable, is to be determined alone by increase or decrease of *income*. In fact, whether there is a profit or a loss is dependent not only upon income, but upon its relation to *outgo*. If income increases and outgo increases still more, there is an increased loss.

Whether a level of rates has undergone increase or decrease during a test period is not a matter of importance; the only pertinent inquiry is as to the relation which exists between income and outgo, and as to the balance which remains after subtracting the latter from the former.

It is significant that in the last two years of the test period, when the January, 1920, increase was in force, the deficiency of income to meet outgo was greater than during the preceding three years; and this is true upon the received and paid basis (Exhibit 1361 at R. 1934) as well as upon the earned and incurred basis (Exhibit 1359 at R. 1925).

16. The Superintendent inferentially attacks the *method of computing* earned premiums and incurred losses and expenses (page 18 of brief). He states the method in such a way as to make it seem very confusing, when in fact it is not so (R. 3017-18). The *method of computation* (as distinguished from the propriety of adopting the earned and incurred basis at all) was not challenged at any place in the record, and could not be. The formula

for computation was the one prescribed *by the superintendent himself* in the annual statement form, the same formula being in use in every state in the Union. (See exhibit following page 2742 of record.) We have anticipated the argument of the Superintendent in this particular, and call attention to our original brief (pp. 44-45).

For all the reasons asserted in our original brief (pages 31-49) we respectfully submit that the use of the received and paid method of calculating underwriting profit is unreasonable, fundamentally erroneous and confiscatory, and that by the reduction in rates predicated thereon the petitioners are denied due process of law.

VII.

As to the application of $2,301,132 interest earnings from the investment of unearned premiums to the reduction of rates for underwriting.

1. The Superintendent attempts to minimize the importance of this point by saying (page 35 of his brief) "This is a small item." As a matter of fact, the item is so large that if the point is decided in petitioners' favor, it will have the effect to invalidate the reduction order. The amount involved in this item ($2,301,132) is nearly four times greater than the narrow margin ($607,040) by which the reduction order is sustained by the opinion below.

2. At page 38 of his brief the Superintendent says that originally the petitioners claimed that it was fair to charge all of their investment expenses against underwriting income as an element of outgo, for the purpose of rate making. Such contention was never made by the petitioners at any time, and the record does not show that it was.

3. At page 39 of his brief the Superintendent says that the deduction of investment expenses made by petitioners to eliminate them from consideration was accomplished by considering such investment expenses as amounting to one-eighth of one per cent of mean invested assets, and that "this is a pure arbitrary figure with no proof whatever anywhere in the record that can be cited of its accuracy." This is an unfair statement, the fact being that *the Superintendent himself* fixed one-eighth of one per cent of mean invested assets as the measure of investment expense. See foot note (d) at the end of the investment exhibit in the annual statement blank (R. 1289-1290). *The Superintendent himself having fixed this percentage*, it comes with very poor grace for him to say that it is "a purely arbitrary figure *with no proof whatever of its accuracy*."

In point of fact investment expense was entirely eliminated, as we have explained in our original brief (pages 54-55).

4. The Superintendent has signally failed to answer the inescapable logic of the dissenting opinion with respect to the inclusion of investment earnings. We respectfully submit that in applying investment earnings from unearned premiums to a reduction of underwriting rates, the rate reduction order is confiscatory and unconstitutional.

VIII.

As to the reduction of $2,496,715 excess commissions from expense.

At page 40 of his brief, the Superintendent says: "No evidence was offered by these insurance companies as to why they should pay greater commissions to agents in St. Louis than in Kansas City or other parts of the

state." At pages 55-56 of our original brief we stated the substance of the evidence upon this point, giving references to the pages of the record where the evidence might be found.

This expense was incurred in good faith, and the evidence shows that it was reasonable and necessary, in view of competitive conditions in St. Louis. It is not for the Superintendent to substitute his judgment for that of the petitioners respecting this matter, which was one requiring business judgment. The disallowance of this substantial item of expense is unreasonable and confiscatory.

IX.

As to the rejection of $628,123 war tax on premiums as expense.

At pages 40-41 of his brief the Superintendent has sought to confuse the federal *income* tax with the federal *war tax on premiums*. He devotes some space to showing why the federal *income* tax item was disallowed, as if that threw some light on the reason why the federal *war tax on premiums* was disallowed. Of course the two taxes are entirely separate, the one having nothing whatever to do with the other. It is extremely difficult to understand the apparent confusion of the Superintendent's counsel as to this matter, considering that they have been in the case throughout and are fully informed as to the difference in the two taxes, which difference was fully explained and brought out in the evidence.

The Superintendent wholly fails to justify the disallowance of the federal war tax on premiums. The fact is that the tax was incurred and paid during the five-year test period. The payment thereof was as much a

part of the petitioners' experience of the test period as any other item of expense incurred. It will not do to say that because the war tax statute was repealed in 1921, the war tax paid during the years 1917 to 1921 should be thrown out of the calculation. The purpose of the calculation was to ascertain the five-year experience. *This war tax was a part of that experience.* It is unreasonable to exclude it.

X.

As to the action of the court in fixing 8% of premiums received, or $6,680,169, as a reasonable profit.

1. At page 10 of his brief the Superintendent says the Missouri Supreme Court held that 8% on the volume of business was a reasonable profit, and that this "was taking everything into consideration after all reserves had been set up." As the opinion *does not purport to make any allowance whatever for reserves*, we are completely at a loss to understand this statement, which has no support whatever in the record.

2. At pages 41-42 of his brief the Superintendent says that petitioners' earnings "were so enormous in Missouri and elsewhere that this 10% reduction would hardly affect them at all." Upon the earned and incurred basis the petitioners concededly sustained an underwriting loss in Missouri during the test period of $7,010,200, as the majority opinion expressly admits (R. 3018, 3007). If the reduction order had been in force during the test period it would have imposed upon petitioners an additional loss of $7,134,751, as the referee expressly found (R. 2942). Yet the Superintendent says "this 10% reduction would *hardly affect them at all.*"

3. It should also be noted that petitioners' earnings "elsewhere" (i. e., outside the State of Missouri) are of no materiality whatever. The Superintendent cannot justify confiscatory rates in the State of Missouri on the ground that petitioners are deriving profits outside the State of Missouri (*Smyth* v. *Ames*, 169 U. S., l. c. 540, 541; *Minnesota Rate Cases*, 230 U. S., l. c. 440; *Northern Pacific Ry. Co.* v. *North Dakota*, 236 U. S., l. c. 585, 599; *Brooks-Scanlon Lumber Company* v. *Railroad Commission*, 251 U. S. 396; *Interstate Commerce Commission* v. *Union Pacific R. R. Co.*, 222 U. S., l. c. 547; *Norfolk & Western Ry. Co.* v. *Conley*, 236 U. S. 605; *Board of Public Utilities Commissioners* v. *New York Telephone Co.*, 46 Sup. Ct. Rep. 363).

XI.

As to the unconstitutionality of the rating statute as construed and applied in the instant case.

The Superintendent's brief presents nothing on this point that has not been fully covered in petitioners' original brief and in section I of this reply brief.

For all the reasons presented in our original brief and in this reply brief, we respectfully ask that the writ of certiorari issue as prayed.

Respectfully submitted,

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